DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR ASSOCIATE AREA COUNSEL,
Attention:
CC:LM:RFP:MIA

FROM: Acting Associate Chief Counsel (Financial Institutions and Products) CC:FIP

SUBJECT: Tax Treatment of Certain Underwriting Fees

This Chief Counsel Advice responds to your memorandum dated July 9, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

LEGEND

Taxpayer =
Agent =
Lender Group A =

Lender Group B =

Lender Group C =

Lender Group D =

Facility 1 =

Facility 2 =

Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
Year 1 =
a =
b =
c =
d =
$e =
$f =
$g =
$h =
$k =
$l =
$m =
$n =
$o =
$r =
$s =
v% =
w% =
x% =
y% =
z% =

ISSUE

Whether Taxpayer's underwriting fees paid to Agent in connection with Facility 1 must be capitalized under § 263 of the Internal Revenue Code?

CONCLUSION

Yes. Taxpayer's underwriting fees paid to Agent in connection with Facility 1 must be capitalized pursuant to § 263(a).

FACTS

We understand the facts to be as follows. Taxpayer and Agent entered into an agreement (Facility 1) on or about Date 1. Facility 1 was a credit arrangement for the benefit of Taxpayer and provided for both fixed and revolving amounts of borrowings. Agent entered into Facility 1 both on its own behalf as a member of Lender Groups A and B, and as the agent for Lender Groups A and B. Lender Group A was comprised of a participants. Lender Group B was comprised of b participants. Agent participated as the principal lender under both groups.[1]

Facility 1 provided for financing totaling $e, consisting of $f in fixed financing and $g in revolving financing. Agent's participation interest under Facility 1 was v% of the revolving loan portion and w% of the fixed loan portion. Each of the other participants in the revolving loan facility held x% interest in the fixed financing portion of Facility 1.

The proceeds from loans made to Taxpayer under Facility 1 were required to be used by Taxpayer for the following purposes: (1) purchase by Taxpayer of a specifically identified business; (2) refinancing of Taxpayer's existing indebtedness (including any associated fees and expenses); and (3) Taxpayer's general working capital needs and other corporate purposes. Facility 1 included a number of terms and conditions governing the subsequent syndication for both fixed and revolving loans. It also provided for a Stated Termination Date (Date 3) that applied to both the fixed and revolving portions of Facility 1.

On or about Date 2, Taxpayer and Agent entered into a second agreement (Facility 2), which provided that, upon Facility 2 becoming effective, Facility 1 was amended and restated in its entirety.[2] Facility 2 also provided for both fixed and revolving financing. Agent entered into this financing arrangement with Taxpayer both on its own behalf as a member of Lender Groups C and D, and as the agent for Lender Groups C and D. Lender Group C was comprised of c participants. Lender Group D was comprised of d participants. Agent again participated as the principal lender under both groups.

Facility 2 provided for $h in maximum revolving financing, and separate fixed financing of $k (the "Term Loan A" facility) and $l (the "Term Loan B" facility). Thus, Facility 2 provided for maximum fixed financing of $m, and total financing

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[1] As used herein, principal lender means only that Agent's participation interests were larger than the interests held by the other participating lenders.

[2] It appears that Facility 2 was substituted for Facility 1 and a portion of the outstanding indebtedness under Facility 1 was satisfied by Taxpayer (using proceeds from certain debt issued by Taxpayer). This arrangement resulted in the reduction of the participation interests held by Lender Groups A and B and the inclusion of new participants in Lender Groups C and D.

(both revolving and fixed) of $n.[3] Agent's participation interest was y% with respect to both the revolving loan and Term Loan A portions of Facility 2, and z% of the Term Loan B portion of Facility 2.

The proceeds of any revolving credit loans made pursuant to Facility 2 were required to be used by Taxpayer for the following purposes: (1) refinancing of Taxpayer's existing indebtedness (including any associated fees and expenses) and (2) Taxpayer's general working capital needs and other corporate purposes. In addition, Facility 2 provided a number of terms and conditions not contained in Facility 1, none of which appears to be inconsistent with the syndication of loan participation interests in the secondary market through restricted offerings.

Facility 2 specifically provided for a Stated Termination Date (Date 4) with respect to the revolving financing portion. Facility 2 also specifically provided for stated maturity dates with respect to the fixed financing.[4] Further, Facility 2 contained specific principal repayment schedules for both Term Loan A and Term Loan B.

Under both Facility 1 and Facility 2, the percentage interests held by the various lenders established their allocable commitments to make funds available to Taxpayer (hereafter, the "loans") in accordance with the terms and conditions of the respective agreements. Both Facility 1 and Facility 2 expressly provided for Taxpayer's payment of commitment fees and certain other costs, including amounts earned by Agent in its capacity as agent.

In addition to the amounts specified in Facility 1 and Facility 2, Taxpayer paid underwriting fees to Agent. Taxpayer paid Agent underwriting fees of $r in connection with Facility 1 and $s in connection with Facility 2.[5] Taxpayer apparently deducted the underwriting fee for Facility 1 ($r) on or about Date 2 when it entered into Facility 2 but capitalized the underwriting fee for Facility 2 ($s).[6] The

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[3] The total amount of financing available to Taxpayer under Facility 1 was $e. The total amount of financing available to Taxpayer under Facility 2 was $n. The difference in amounts available to Taxpayer under Facility 1 and Facility 2 was $o.

[4] The Term Loan A Maturity Date is Date 4 and the Term Loan B Maturity Date is Date 5.

[5] No information was provided in the incoming materials about the nature of the services performed by Agent in exchange for the underwriting fees. We assume that these underwriting fees are in addition to, and separate from, the commitment fees and other fees earned by Agent that are specifically identified in the terms and conditions of Facility 1 and Facility 2, as we found no reference to the $r and $s fees at issue in the documents provided for our review.

[6] For purposes of discussion, we assume that Taxpayer capitalized the $s underwriting fee and amortized it over the life of Facility 2. No details were provided,

examining agent is seeking to deny Taxpayer any deduction with respect to the $r underwriting fee, proposing instead to capitalize both underwriting fees through Year 1.

LAW AND ANALYSIS

It is well-settled that amounts paid by a borrower for services rendered in connection with obtaining a loan are required to be capitalized. See Sleiman v. Commissioner, T.C. Memo. 1997-530, aff'd on another issue,187 F.3d 1352 (11th Cir. 1999); Enoch v. Commissioner, 57 T.C. 781, 794-95 (1972); Lovejoy v. Commissioner, 18 B.T.A. 1179 (1930). Accordingly, because the $r underwriting fee was paid to Agent by Taxpayer solely to compensate Agent for its general services in securing financing for Taxpayer, the fee must be capitalized.

Generally, capitalized costs incurred by a borrower are amortized ratably over the term of the loan to which the costs relate. See Enoch v. Commissioner, 57 T.C. 781, 794-95 (1972), acq. on this issue, 1974-1 C.B. 1; Rev. Rul. 81-161, 1981-1 C.B. 313. Where a loan is repaid prior to maturity, any remaining unamortized capitalized costs of obtaining a loan may be deductible upon the satisfaction of that loan with proceeds from another loan, even if such proceeds are obtained from the same lender. See Buddy Schoellkopf Products v. Commissioner, 65 T.C. 640 (1975), acq. on this issue, 1981-2 C.B. 2 (fn. 9). Thus, Taxpayer's position with respect to deducting the $r fee for Agent's services in connection with Facility 1 at the time it entered into Facility 2 is not without a basis in the law.

However, there may be instances where the second loan from the same lender does not result in the satisfaction of the first loan, but instead constitutes the refinancing or an extension of the original loan. In such circumstances, the proper period for amortizing the capitalized costs of obtaining the first loan includes the term of the second loan. See, e.g., Wilkerson v. Commissioner, 70 T.C. 240 (1978), rev'd on another issue, 655 F.2d 980 (9th Cir. 1981)(court held that fees paid to the construction lender for services were paid to secure for borrowers the financing needed for the entire project, not just the construction phase; therefore, the fees were required to be capitalized and amortized over the entire permanent financing period). Whether a subsequent financing arrangement with the same lender is more properly viewed as a satisfaction of the first loan with proceeds from a separate second loan, or simply as an extension or refinancing of the first loan, is a factual question. See Sleiman v. Commissioner, supra.

In Sleiman, the Tax Court found that permanent financing obtained from the same lender from which the borrower secured construction period financing nevertheless was a separately bargained for second loan and allowed the petitioners to deduct

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however, with respect to the useful life determined by Taxpayer for Facility 2, or the manner in which Taxpayer computed any amortization deduction.

unamortized loan fees incurred in connection with the construction loan over the one-year term of that loan. Relevant factors considered by the court included: (1) the fact that the construction period and permanent financing loans were separately bargained for by the parties; (2) the relevant loan agreements contained materially different terms and conditions (including different interest rates, prepayment premiums, and repayment periods); (3) the construction loan agreement made no mention of permanent financing; (4) the permanent financing was secured less than a month prior to the due date of the construction loan; and (5) the borrower paid a second, separately negotiated, commitment fee at the time the permanent financing was secured.

Applying the Tax Court's analysis in Sleiman to the facts of this case, we note that it is possible to view both Facility 1 and Facility 2 as two separate lending transactions. See also Buddy Schoellkopf Products, supra (second loan arose from the borrower's need for new funds requiring a new loan whose terms were separately bargained for, even though the second loan was placed with the same lender); but see Williams v Commissioner, T.C. Memo. 1981-643 (use of separate sources of funds for construction and permanent financing periods did not preclude the aggregation of their respective terms for purposes of determining the proper period for amortizing capitalized costs which benefit the entire loan); Lay v. Commissioner, 69 T.C. 421 (1977) (mortgage broker's fee paid by borrower was for services rendered in connection with originating a favorable loan package to fund two housing projects rather than for services performed as a preliminary lender and, therefore, the fee was not deductible when paid but, instead, was amortizable over the life of each loan on the respective projects). However, based on our review of the two Facility agreements, it appears that the parties always intended Facility 1 to be an interim financing arrangement that would, in a relatively short time, be transmuted into a more permanent form of financing. Facility 2 provided for that longer-term source of funds, replacing the funds originally obtained by Borrower under Facility 1.

Further, it appears that both Taxpayer and Lender Groups A and B contemplated from the inception of Facility 1 that any loans made pursuant to Facility 1 could be further syndicated by the participating lenders. As such, Facility 1 appears to have been a necessary precursor step to Taxpayer's obtaining that more permanent Facility 2 financing (similar to the situation at issue in Williams v. Commissioner, supra). In such circumstances, capitalized fees paid with respect to Facility 1 would be required to be amortized over the combined terms of Facility 1 and Facility 2.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

[redacted]

[redacted] [7] [redacted] [8] [redacted] [9]

[redacted]

[redacted]

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[7] [redacted]

[8] [redacted]

[9] [redacted]

[redacted]

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Please call if you have any further questions.

By: DAVID B. SILBER
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